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No. 86-887

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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1986

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LARRY W. PASSAGE, et al.,

Petitioners,

vs.

PRUDENTIAL-BACHE SECURITIES, INC., et al.,

Respondents.

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REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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This Reply Brief is submitted to the Court pursuant to Supreme Court Rule 22.5, in answer to Respondents' Briefs in Opposition to the Petition for a Writ of Certiorari to the Supreme Court of the State of Montana.

The Petition for Certiorari raises the question as to the constitutionality of applying the Federal Arbitration Act to an adhesive arbitration clause which does not notify the adhering party that, in agreeing to arbitrate, he is waiving his right to trial by jury and judicial resolution of disputes.

THE QUESTION PRESENTED WAS PROPERLY RAISED IN THE LOWER COURTS

Although the Murray Respondents agree that both the State District Court and the Montana Supreme Court "fully considered" and decided the issues presented, (Murray, Brief in Opposition, page 4), Prudential contends that the issue presented has been "fashioned out of thin air", that it was neither raised nor ruled upon by the lower courts. The record, however, is clear that Passages have consistently contended that the arbitration clauses are revocable upon grounds that exist in equity or at law. (9 U.S.C. Sec. 2) In particular, that the clauses are unenforceable because they fail to advise adherents that, in agreeing to arbitrate, they are waiving their right to a jury trial.

The state district Court specifically acknowledged Passages' contention that the arbitration clauses were "contracts of adhesion" and therefore should be closely scrutinized and revoked upon grounds as exist in law or equity. (App. pp. 14-15). Although the District Court recognized the constitutional implications of an arbitration agreement (". . . an arbitration agreement is a waiver of the right to bring an action in court . . . " App. 16) it found that there were no grounds in law or equity for revocation of the clause in question.

In the Montana Supreme Court the Passages contended that the Federal Arbitration Act was unconstitutional as applied to the clauses in question since the Passages were not put on notice that they were waiving their right to a judicial forum.* (Passages' Appeal brief, pp. 7-12 and Reply Brief, pp. 4-5, filed with the Montana Supreme Court.) Both Prudential and Passages addressed this issue extensively during oral argument.

The Supreme Court passed on the issue by holding that even if the agreement were "adhesive", there was nothing in the record indicating that the parties' reasonable expectations had been exceeded or that the clause was unconscionable. (App. 7). In the view of the Montana Court, such provisions are "common" and "universal" in brokerage contracts and therefore the client is presumed to know and appreciate the consequences. Although this was less than an analytical approach, the issue was, nonetheless, passed upon.

The Court's cursory treatment of the issue is due, in large part, to the Court's having tacitly agreed with Prudential's argument that the Passages failed to refute the existence of any waiver of rights. Or stated another way, that the Passages failed to prove that the clauses exceeded their "reasonable expectations." As discussed below, however, the Court imposed the burden on the wrong party. It was *Prudential* that had the burden of establishing a valid waiver of a constitutional right.

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*In their brief before the Montana Supreme Court, pages 11-12, the Passages clearly argued as follows:

"The Nevada Court found the Pepper contract [693 P.2d 1259] to be a contract of adhesion even though the clause in question expressly waived the right to trial. It is significant that the arbitration clauses which were signed by the Passages do not even go that far. The Passages were not put on notice that they were waiving their rights to claim punitive damages and to receive a jury trial.

The Bache arbitration contract is a contract of adhesion which must be subject to close judicial scrutiny and should not be routinely enforced. Since it was Prudential-Bache that was the moving party (to compel arbitration), Prudential must establish the validity of the arbitration clause, i.e., plain and clear notification of its terms and an understanding consent. Prudential-Bache has not carried this burden and the contract must be declared unenforceable. As applied to the contracts in question, the National Arbitration Act is unconstitutional."

In their Reply Brief, pages 4-5, Passages argued:

"In the context of a contract of adhesion, the drafting party must show that the adhering party was notified of the terms and understood that he was waiving his constitutional right to a trial by jury; waiving his right to punitive damages, and waiving his right to appeal and seek judicial review. The arbitration clauses in question certainly do not contain any such explicit notice, and Prudential has made no attempt to prove that the Passages understood the effect of the arbitration clause."

Prudential Contends that Passages Failed to Prove that the Arbitration Clause Exceeded Their "Reasonable Expectations"

Prudential and Murray oppose the Petition on the basis that there is no evidence that Passages failed to read the clause; that they did not understand the clause or that they did not understand that they were waiving rights. Accordingly, Prudential concludes, ". . . we must assume they knew what they were doing." (Prudential's brief, p. 6). This position, which was adopted by the Montana Supreme Court, mistakenly assumes that Passages had the burden of producing evidence to refute a waiver of their right to a jury trial.

The arbitration clauses in question are boilerplate contracts which require the securities client to arbitrate all disputes. The form contracts contain no explanation of what arbitration means and no disclosure that, in signing the agreement, the client necessarily waives his right to trial by jury and full appellate review.

Prudential's position ignores the fact that an adhesive arbitration clause constitutes a waiver of the constitutional right to trial by jury. It is, therefore, the parties asserting the waiver (Prudential/Murray) who must prove a clear notification of the contract terms.

Montana's Constitutional Guarantee of Right to Trial by Jury is Protected by the Due Process Clauses.

In Montana, the right to trial by jury is guaranteed by Article II Section 26 of the 1972 Montana Constitution, which provides, in pertinent part, that, "The right of trial by jury is secured to all and shall remain inviolate." The State of Montana having granted litigants a constitutional right to trial by jury, such right is protected by the Due Process clauses of the Fifth and Fourteenth Amendments to the United States Constitution. *Lecates v. Justice of Peace Court No. 4 of State of Delaware,* 637 F.2d 898, 909 (3rd Cir. 1980). (surety bond requirement for state jury trial held violative of due process).

Since execution of an arbitration agreement constitutes waiver of a right protected by the Montana Constitution, it is the parties asserting waiver of that right (Prudential/Murray) who must make a showing that their clients are made aware of the arbitration clause and its significance.

A Waiver of Constitutional Rights Must, on its Face, be Clear

In *Fuentes v. Shevin,* 407 U.S. 67, 94-96 (1972), this Court held that state replevin statutes which did not provide for pre-seizure notice and hearing were unconstitutional under the Due Process Clause of the Fourteenth Amendment. The states of Florida and Pennsylvania had argued that the appellants, who signed conditional sales contracts, thereby waived their Due Process rights. The Court cited *D. H. Overmyer Co. v. Frick Co.,* 405 U.S. 174, 187 (1971), for the proposition that contractual waiver of Due Process rights must be "voluntarily, intelligently, and knowingly made." The Court noted that the Overmyer contract was a negotiated contract where the parties were "aware of the significance" of the waiver provision.

Contrary to *Overmyer,* the *Fuentes* contract provisions, like those sub judice, were in a printed form contract "unaccompanied by any explanations clarifying their meaning." 407 U.S. at 94. In short, the Fuentes conditional sales contract was a contract of adhesion.

In *Overmyer,* the Court observed that "where the contract is one of adhesion, where there is disparity in bargaining power, and where the debtor receives nothing for the [waiver] provision, other legal consequences may ensue." 405 U.S. at 188. In reviewing the conditional sales contract in *Fuentes,* the Court found that there was no need to concern itself with what those "other legal consequences" might be.

> "For a waiver of contitutional rights in any context must, at the very least, be clear. We need not concern ourselves with the involuntariness or

> unintelligence of a waiver when the contractual language relied upon does not, *on its face,* even amount to a waiver." (emphasis added) 407 U.S. at 95

It is further significant that the Court not only found the document deficient on its face, but also found that the parties asserting waiver had made no showing of actual waiver.

> "The appellees made no showing whatever that the appellants were actually aware or made aware of the significance of the fine print now relied upon as a waiver of constitutional rights." 407 U.S. at 95.

The principles established in *Fuentes* for interpretation of contracts of adhesion are equally applicable to the Prudential-Bache client agreement. An agreement which is nothing more than a bald requirement to arbitrate all disputes with no explanation of what "arbitration" means or the waivers inherent in such an agreement.

The Montana Supreme Court has held that courts indulge in every reasonable presumption against waiver of fundamental constitutional rights and "will not indulge in any presumption of waiver." *State v. Lucero,* 445 P.2d 731, 735, 151 Montana. 531, 538 (1968) (right to appointment of counsel) (citing *Johnson v. Zerbst,* 304 U.S. 458 (1937)). The United States Supreme Court has stated: "Indeed, in the civil no less than the criminal area, 'courts indulge every reasonable presumption against waiver.'" *Fuentes v. Shevin,* 407 U.S. at 94, footnote #31, citing *Aetna Ins. Company, v. Kennedy,* 301 U.S. 389, 393 (1936)

The Requirement of Clear Notification of Waiver does not Conflict with the Policy Favoring Arbitration.

Prudential and Murray contend that there is nothing in the record demonstrating that the clauses in question exceeded the reasonable expectations of the parties. Therefore, Prudential argues, the exception language in 9 U.S.C. Sec. 2 does not come into play and the Petition for Certiorari should be denied. This position, however,

assumes that there is a presumption of validity to the bald agreement to arbitrate and that the Passages failed to rebut that presumption. In fact, there is a presumption *against* the waiver of constitutional rights and *Prudential* must overcome that presumption in order to establish waiver.

The presumption against waiver of constitutional rights is not a presumption against arbitration. However, since an arbitration agreement necessarily implies a waiver of judicial resolution, (a fact recognized by the District Court, App. 16), a party relying on an adhesive arbitration clause must employ language which demonstrates, at the very least, a "clear" waiver of trial by jury and full appellate review. See *Fuentes v. Shevin,* 407 U.S. at 95.

CONCLUSION

The arbitration clause is in the record. (See attachment to Appendices to Petition) Like the *Fuentes* contract, Prudential's arbitration clause does not clearly demonstrate a waiver of a constitutional right. It is deficient on its face.

If, in fact, the record is lacking as to the parties' knowledge or expectations, that deficiency is the result of *Prudential's* failure to make a showing of actual waiver of the right to trial by jury.

For the above stated reasons, a writ of certiorari should issue to review the opinion of the Supreme Court of the State of Montana.

Respectfully submitted,

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